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SUBJECT: KOSOVO'S FINAL STATUS BURDENS ECONOMIC TIES

11. (U) This is a joint cable from USOP and Embassy Belgrade.

#### SUMMARY

12. (SBU) Belgrade econ chief and Pristina econ officer made the rounds of UNMIK and PISG economic agencies to identify some of the economic issues that are factors in current and future relations between Kosovo and Serbia. Trade is a bright spot, with imports from Serbia up some one-third in 2006, although some issues still have not been resolved. The payments system appears to be gradually improving, in part because of Belgrade-based Komercijalna Banka's decision to obtain a license from the Central Banking Authority of Kosovo. Power transmission appears to be a bit smoother, according to Kosovo Energy Company (KEK) officials, but the relationship still is troubled by sovereignty-linked disputes over payments. Telecom remains a sore point, with Kosovo's telecom regulator determined to drive out Telekom Srbija's substantial cellular business, while the Government of Serbia sticks to a hardline on other telecom issues. Key privatizations that could benefit Kosovo Serbs appear to be frozen by political uncertainty. END SUMMARY.

#### THAW IN TRADE RELATIONS

13. (SBU) Peter Walker, UNMIK Customs director, welcomed econ officers on February 7. He described a gradual thaw in trade relations over the last five years, culminating in Serbia's lifting of its transit tax on third-country goods in 2005. (In addition, Serbia permits VAT refunds on goods transported to Kosovo, as is common practice on exports.) The easing of restrictions resulted in a big increase of Serbia-origin exports to Kosovo in 2006, from about EUR 130 million to EUR 189 million. Some 25-30 percent of Kosovo's exports enter from Serbia, he said. (Note: Serbia's trade data is considerably different, showing exports of USD 528 million in 2006; the issue is further complicated by the fact that 2005 data included Montenegro.)

14. (SBU) The thaw was not without its problems, Walker noted. The shift of trade to Serbian border points in 2005 and 2006 had resulted in initial revenue losses estimated at some EUR 20 million. Customs staff in the north is mostly Serbian, and UNMIK suspects that corruption, at least partly driven by organized crime, had undermined staff performance. Additional security measures had been employed, and losses have declined, he added.

15. (SBU) Further easing of trade could be accomplished through administrative and logistical improvements, Walker said. For instance, seasonal backups can last hours at Gate 3, north of Podujevo, because of the heavy flow of summer returnees mixed with commercial traffic on a two-lane road. A simple by-pass, combined with an UNMIK agreement to accept Serbian documentation cleared at a checkpoint inside Serbia, could facilitate trade, he said. He noted

that Serbian fuel exports should be booming, based on the increase of a Macedonian fuel excise tax at the beginning of 2007.

#### PAYMENTS SYSTEM NORMALIZES

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¶16. (U) The increase in trade may be driven in part by an easing of payments. Komercijalna Banka, a Belgrade bank controlled by state shareholders, has obtained a provisional license from the Central Banking Authority of Kosovo and now operates nine offices in Kosovo.

(These are located largely, but not exclusively, in Serbian enclaves.) Econoffs met with Kosta Sandic, a Komercijalna manager from Belgrade, and two local managers at the bank's Mitrovica branch on February 8.

¶17. (SBU) Sandic said that Komercijalna's business in Kosovo is largely driven by trade. National Bank of Serbia regulations permit Komercijalna to do business in Kosovo either in dinar or euro, at a competitive rate fixed in Belgrade. (Komercijalna obtains cash from the National Bank of Serbia branch in Leposavic.) Many Albanian traders from Southern Serbia use Komercijalna Banka, he said, and management expects such activity to increase. Another source of growth may come from UNMIK payments to Serb property owners; Komercijalna has been approached by the UN Habitat agency about handling the payments work. However, the bank closely controls lending in Kosovo, since real property pledged as collateral has proved not to be sellable, he said.

¶18. (SBU) Komercijalna is not the only bank serving Kosovo Serbs. Jugobanka Kosovska Mitrovica and Kosovsko Metohiska Banka, based in Zvecan, also serve the enclaves. But Sandic observed that the two banks are not making money and might face difficulty in meeting the requirements of the Central Banking Authority of Kosovo. (Supervision officials at the National Bank of Serbia told us that they supervise these banks only through off-site supervision, since on-site visits are not practical.) However, Komercijalna intends to expand as political conditions improve; Sandic said that the bank has hired Kosovar staff and made a commitment to use mixed-ethnicity branch teams.

#### ENERGY: PROGRESS ON AGAIN, OFF AGAIN

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¶19. (SBU) Econoffs met with a variety of energy sector interlocutors in Kosovo. Kosovo Energy Company (KEK) officials said that power availability has been better this year, for which they also credit their decision to contract with energy traders for delivery at Kosovo's borders. However, officials at the PISG Ministry of Energy and Mining complain of Serbia's continuing failure to recognize its Transmission System Operator as a separate entity and remit revenues based on transit of power through Kosovo to third parties. And they expressed unwillingness to consider the sort of independent power distributor that Serb officials seek for the enclaves.

¶110. (SBU) Pranvera Dobruna, KEK managing director, described an uncertain outlook for cooperation with Serbia. Serbian enclaves still do not pay for power, but she said that local Serbian electricity company representatives had responded to appeals to conserve power in the enclaves over the holidays. And power availability to consumers had been better this year, she said, in part because of milder weather but also because of such cooperation. One result was better power availability in the enclaves. (This was confirmed by Serbian power company officials in north Mitrovica.)

¶111. (SBU) Regarding the GOS offer (through the Coordination Center for Kosovo, CCK) of a power donation of 50 gigawatt-hours per month, Dobruna said that the proposal simply was not feasible. Switching on service areas below the 10-kilovolt feeders on a 24-hour basis would require 130 gigawatt-hours, leaving KEK to pay for the other 80 not covered by the Serb donation. Regarding the Serb proposal to switch power on at smaller substations below the 10-kv level, Dobruna said that this would require that KEK crews drive around constantly, turning power on and off every three hours at the smaller service areas not included in the Serb offer, a prospect that simply was not practical.

¶112. (SBU) Handing econoffs an e-mail correspondence with Serb power officials, Dobruna complained sharply about a January 29 incident in

which KEK's request for an emergency power transfer through the Serbian transmission network was allegedly rejected by Serbian transmission authorities because only state power utilities can deliver emergency power. (The transfer had been contracted through a trader, the Energy Financing Team.) She said that the Serbs had delivered emergency power on previous occasions. Dobruna said that non-emergency deliveries had been more regular this year because KEK had adopted the policy of requiring that power traders deliver directly to Kosovo's borders, shifting responsibility for arranging transmission through Serbia (or a third country) directly to the seller.

¶13. (SBU) The KEK director also expressed exasperation with Serbia's policy of non-recognition of Kosovo's Transmission System Operator (TSO). In practice, this means that Serbia is not compensating Kosovo for transfers of power through its territory, but instead is retaining the revenue with the argument that it still owns the transmission system. This revenue loss may amount to EUR 5 million by now, she said.

¶14. (SBU) Merita Kostari, head of the legal department at the UNMIK Energy Regulatory Office, said that Kosovo would file a complaint on this issue. Kosovo's TSO is now a fully recognized member of the Southeast Europe Transmission System Operators Association, but Serbia has blocked its admission to the cross-border trading mechanism that allocates capacity and revenues. Kosovo would raise this issue in February at the next regional TSO meeting in Athens, she said.

¶15. (SBU) Econoffs raised the issue of licensing a separate power distributor to operate in Serbian enclaves. Kostari said that, under Kosovo's energy law, only the PISG could nominate such a distributor; it could not apply independently.

¶16. (SBU) Agron Dida, deputy Minister of Energy and Mining, expressed similar frustration with Serbia's approach on cross-border transfers. Serbia had paid such compensation to Kosovo until 2004, then had stopped, raising over and over their contention that system assets belong to Serbia. In January 2006, when Kosovo sought more power to cope with demand related to the funeral of Ibrahim Rugova, the Serbs had stopped a Bulgarian offer to provide power but then offered to sell the power to KEK at a much higher price.

¶17. (SBU) The Ministry had requested that UNMIK not accept Serbia's offer to donate power, Dida said, as it would mean "anarchy." The Serbs still see Kosovo's system as part of their system, and they instruct Serbs not to sign contracts with KEK because they do not want to recognize the rule of law in Kosovo. When econoff raised the issue of creating a separate distributor to facilitate payment by Serbs, one of Dida's assistants insisted that the Serbs could function only as a supplier, to collect payments, but not as a distributor with independent control of a sub-network.

#### TELECOMS A BATTLEGROUND

¶18. (SBU) Anton Berisha, chairman of Kosovo's Telecommunications Regulatory Authority (TRA), describes a situation in which the Kosovar and Serbian systems have been largely de-linked. Although fixed line calls to Kosovo still use Serbia's country code and, to some extent, transit Serbian infrastructure, Telekom Srbija has completely ended its reliance on Kosovo's fixed line network, instead using radio relay for fixed line service to the enclaves. Berisha said that once the TRA had dismantled a Telekom Srbija cellular tower, only to find it had disrupted fixed line service to an enclave, as well. With regard to frequency spectrum, Telekom Srbija simply uses what it wants without permission, he said. Serbia is still blocking Kosovo's request to obtain a country code from the International Telecommunications Union.

¶19. (SBU) Fixed line service works without problems, Berisha said, although he asserted that he was not familiar with any arrangements under which long-distance revenues are shared with Telekom Srbija. But he left no doubt that the TRA is determined to push out the cellular operators from Serbia, Telenor and Telekom Srbija's MTS service. Telenor chose not to participate in Kosovo's tender for a second mobile operator, he said, and it must leave the Kosovo market. Such frequency use is unlicensed, he argued. Kosovo's

state-run telecom, PTK, has filed a lawsuit in Kosovo's courts against Telenor, seeking to end the company's operation in Kosovo. Berisha said TRA would respect UNMIK's order not to dismantle cellular towers in enclaves, but said that Telekom Srbija had reacted to TRA's dismantling of towers outside enclaves by locating towers on property of the Serbian Orthodox Church.

¶20. (SBU) Ilija Ivanovic, Telekom Srbija's manager for Kosovo (based in Kosovska Mitrovica, the northern half of Mitrovica), confirmed that TRA had dismantled 15 of the company's cellular towers about 10 weeks previously, damaging equipment and shrinking the company's coverage over Kosovo. He did not deny that Telekom is using church property but insisted that it does so for technical reasons. However, he said Telekom's cellular service still has 300,000 customers in Kosovo, most of them Kosovars who use it because it is better and cheaper than the single TRA-licensed operator.

¶21. (SBU) However, Ivanovic claimed the TRA, backed by Kosovo Police Service (KPS) units, tried to take down two towers in Zvecan and Trpca, but were prevented from doing so by Serbs, who then mounted a 24-hour watch on the sites, he said. In addition, the PTK had carried out work adjacent to a fixed line cable installed by Telekom, without actually seeking to dismantle Telekom's cable. He described a situation in which Telekom crews work throughout Kosovo at their own risk, at times prevented from carrying out their work by Kosovo authorities. Telekom had requested that UNMIK cease efforts to undermine its system, Ivanovic said, but had not responded to UNMIK's suggestion that it bid for a license: why bid for a license when Telekom has one valid for all of Kosovo? (Note: PTT Representative for Kosovo Randjel Nojkic told USOP that no telecom equipment north of the Ibar River has ever been dismantled. End note.)

¶22. (SBU) Andreas Wittkowsky, deputy head of UNMIK's Pillar IV, said that Telekom Srbija had exploited a gentlemen's agreement allowing them to sell SIM cards in Kosovo to expand their operation for commercial reasons, not to serve minorities. And its fixed line network operates in Kosovo in violation of UN Resolution 1244. But UNMIK has prevented disruption to Telekom services in the enclaves for political reasons, he said.

¶23. (SBU) The pushing and shoving over links between Kosovo and Serbia continues in a number of areas, Wittkowsky said. Serbia recently had changed its policy on bus transit to require that operators use Serbian-registered buses. Previously, Kosovar operators had been permitted to use buses registered in third countries and pay a small fine, but Serbia suddenly began to force passengers to disembark at the border and continue on Serbian-registered buses, at a much higher cost. Serbia still is blocking UNMIK's request for membership in the International Railway Union. Serbian state airline JAT recently filed an application requesting permission to fly to Pristina, Wittkowsky said, but PISG authorities argued against granting permission without a deal to unblock use of Serbian airspace for Pristina flights.

Privatization: Future On Hold

¶24. (SBU) Privatization in Serb enclaves has been informally put on hold pending greater political clarity, Ahmet Shala, deputy director of the Kosovo Trust Agency (KTA), told econoffs. Sale documents for the Brezovica ski center had been prepared, but the sale was delayed at the behest of UN authorities in New York, he said. KTA had consulted extensively with Serbs in the Strpce enclave, including the ski center's general manager, and agreed to include their conditions on to employment and investment issues. But starting the tender required a political decision, he noted.

¶25. (SBU) With regard to the Trepca lead mining complex, the outlook is even more complicated because of the geography of the complex and because of conflicting views within the PISG, Shala said. Two mines are practically on the border with Serbia, the concentrator mill is in the enclave town of Leposavic, while other facilities are in Albanian areas. Production recently has restarted with some EUR 60 million in public subsidies, and the PISG is seeking to appoint an administrator for property. The new advisory board includes Kosovo Serbs, he noted. But there is no political consensus even within the PISG, Shala said, with the prime

minister's key adviser skeptical about privatization.

¶26. (SBU) Comment. This series of meetings in Pristina and north Mitrovica illustrated clearly that much of Kosovo's economic future is tied up in disputes with Serbs and with the Belgrade government. In many areas, the elements of a quid pro quo are apparent, but there is little political will at this point to negotiate. The outlook for major investments, whether it is in development of the lead mines at Trepca, the ski center at Brezovica, or in the energy tender, will be influenced by the course of status talks and the temperature of the relationship between Pristina and Belgrade. End Comment.

¶27. (U) USOP is grateful to Embassy Belgrade and to econ chief Mark Bocchetti.

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